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C O N F I D E N T I A L SECTION 01 OF 04 LAGOS 002422

SIPDIS

E.O. 12958: DECL: 11/25/2013
TAGS: EPET ENRG PINR EINV NI
SUBJECT: NIGERIA'S TRANSITION TO A DEREGULATED DOWNSTREAM SECTOR

REF: A. LAGOS 2330
¶B. LAGOS 2078
¶C. ABUJA 1700
¶D. ABUJA 1737
¶E. LAGOS 2090
¶F. LAGOS 2100
¶G. LAGOS 2322
¶H. LAGOS 2287

Classified By: J GREGOIRE FOR REASONS 1.5 (B) AND (D)

¶1. (C) SUMMARY. At the monthly Businessman's Lunch held at the American Guest Quarters pub in Lagos on November 6, executives of two major fuel marketing companies confirmed that the sector is essentially deregulated, and that there is no significant threat of mass action by organized labor (ref A). They noted that the industry must have regular access to dollars to pay for their fuel imports, and suggested that changes are needed to the Nigerian Dutch Auction System (DAS) for currency exchange in order to handle the volume of exchange the marketers require monthly. END SUMMARY.

THE RECENTLY OLD SYSTEM

¶2. (SBU) Until October 2003, Nigeria's downstream petroleum sector had been closely regulated and controlled by the GON (ref B). Retail sellers faced both price ceilings on all refined products as well as profit margin caps and "bridging" fees collected ostensibly to help move fuel to the north from southern refineries and from the port of Lagos. Nigeria's four refineries have never worked at full capacity, and their production has never met domestic demand. Thus, even as Nigeria became the world's seventh largest exporter of crude oil, it found itself importing much, if not most, of its refined fuel needs through private marketers and the Nigerian National Petroleum Corporation (NNPC).

¶3. (SBU) As world market prices for fuels increased in recent years, private marketers eventually stopped importing fuel because they could not sell it profitably given GON price ceilings. By 2002, NNPC was essentially the sole importer of fuels to Nigeria. (Note: Depending on the state of the country's refineries, imports generally account for 60 to 100 percent of domestic fuel supply. NNPC benefited from GON subsidies as it imported fuel at market prices but sold it to private marketers wholesale and to consumers through several retail outlets at the artificially low price caps. When its refineries worked, the Nigerian National Petroleum Corporation (NNPC) was also allowed to buy oil from Nigeria's crude production at prices far below market. This two-pronged NNPC subsidy was said to cost the GON some two billion dollars annually. In late June 2003, the GON raised the price ceiling (effectively raising the price) of gasoline to 40 naira per liter from 26. A nationwide protest strike that resulted in scattered violence and several deaths effectively shut down the country for eight days. A compromise was reached setting the price for gasoline at 34 naira per liter.

THE ARRIVAL OF DEREGULATION

¶4. (SBU) This system changed dramatically when President Obasanjo deregulated the downstream sector by pronouncement on October 1, 2003 (ref C). Although private marketers believed Obasanjo had promised them that all price caps would be lifted and prices would be market driven from that day forward, the NNPC maintained its selling price at the previously imposed ceiling. Consumers became confused overnight, as private fuel stations began charging 40 naira per liter or more for gasoline, while NNPC stations kept their price at 34. Panic buying soon escalated tension and black market prices, and fuel queues began snaking from stations once again. When confronted by angry accusations

from an array of fronts that he had unilaterally raised fuel prices for the second time in six months, Obasanjo replied that any increase in fuel prices was not his doing. He insisted that he had merely deregulated the downstream sector; retailers were now setting prices. This left private marketers politically exposed, and gave the Nigerian Labor Congress (NLC) a vehicle from which to rally. The NLC denounced both Obasanjo for failing to consult civil society before making such a significant change to government policy and operations, and the fuel marketers for taking advantage of the common man for the sake of profits.

¶5. (SBU) The country was headed for another nationwide work stoppage when an agreement to avert the strike was reached late on October 8 (refs D, E). But the agreement unraveled almost as soon as it was reported (ref F). The unions insisted that marketers agreed to keep prices at 34 naira per liter for at least one month while a Stakeholders Committee was formed and would meet to discuss and manage deregulation. Marketers maintain they did not agree to continue selling at the previous price cap. They say they tacitly agreed that prices would likely remain at 34 naira until the first shipment of fuel imported by marketers hit the Lagos port. (Marketers maintain that the lowest viable price for gasoline is currently 40 naira per liter.) The marketers claim union officials misjudged how long it would take the first industry shipment of gasoline to arrive; while unions believed it would be at least four weeks, Unipetrol had already placed an order for two shipments relying on the President's pledge to deregulate, and those shipments were underway as the strike deal was reached. Subsequently, just days after the supposed "agreement," prices again jumped overnight. NLC leaders claimed they had been duped, and some union elements began targeting private dealers for pickets, protests and even violence. In the confusion some dealers closed, inciting passions even further as consumers had even less fuel available to them and opportunists and black-marketers took advantage of the supply crunch.

¶6. (SBU) Most marketers rolled back their prices quietly to avoid confrontation, but as the stalemate dragged on and the federal government appeared intransigent, the NLC's pressure and sway on the issue began to weaken and fade. By the end of October, most union leaders admitted they retained too little momentum to call the strike back on. The Stakeholders Committee met but accomplished little, and Obasanjo took other shots at the NLC via legislation to curtail it's power (ref G). Meanwhile, marketers continued to import fuel, and NNPC itself shifted to market prices. By the third week of October, fuel queues in Lagos all but vanished, and the average cost of gasoline now hovers around 39 to 42 naira per liter. As had been the case even when the GON imposed a price cap, fuel prices in regions outside of urban centers vary, as supply to bush regions and to the north is spotty. (Note: domestic disturbances also affect fuel availability. For example, Econoff noted on November 13 and 14 that long and testy fuel queues stretched throughout the southern city of Port Harcourt. Earlier in the week, demonstrations and violent clashes sparked by the murder of a traditional ruling chief blocked the road between the city and the nearest fuel depot, causing a supply crunch by Thursday, and a run on re-opened stations on Friday.)

DEREGULATED, BUT WATCHED AND PRODDED

¶7. (C) At the Businessman's Lunch on November 6, John Pototsky, Managing Director of Mobil Nigeria, and Jules Harvey, Vice President for West Africa of Texaco International, said the marketers have been told by GON officials at the NNPC, the Department of Petroleum Resources (DPR) and the Petroleum Products Pricing Regulatory Authority (PPPRA) that while the downstream sector is operating in a deregulated environment, the agencies do not want to see widely varying prices around the country and between retailers. Pototsky said the industry has been warned, "don't cause chaos with prices." He said there seems to be a regional split forming within the ranks of decision makers and regulators, with northern government officials winning dominating policy decisions these days. Some have called for price fixing and the continuation of the Petroleum Equilisation Fund (PEF), which is essentially a tax on sales to pay marketers for costs associated with transporting fuel from the Lagos port to the north (known as "bridging").

¶8. (C) Pototsky also noted that the GON seems focused only on gasoline prices; officials ignore what the retailers charge for diesel or kerosene, which are the fuels primarily used by industry and businesses. The same can be said for organized labor. From the outset of the deregulation effort, all

attention has been on the price of gasoline. Even the agreement reached on October 8 accepted that kerosene and diesel prices would immediately rise to market rates. (Note: Because of Nigeria's inadequate power grid, almost all businesses use generators to supply backup or primary power, adding a significant cost to doing business here. Nigeria's stagnant textile industry has linked deregulation to an effect on production by publicly claiming some 50,000 jobs may be lost due to the increased cost of running textile mills after a rise in NNPC's "black oil" price and an alleged diversion of industry fuel allotments.)

¶9. (U) Meanwhile, the DPR has issued new guidelines and directives for marketers on issues including import licensing, quality control and safe transportation of products.

PLENTY OF FUEL...

¶10. (C) Mobil's Pototsky and Texaco's Harvey indicated that the industry is fully engaged in fuel importation. Pototsky was quoted in the press as saying his company anticipated importing 13.4 million liters of gasoline in three shipments by mid-November. (Note: Pototsky and Harvey noted that most gasoline imported to Nigeria is unleaded -- now the most common gasoline available on world markets -- even though vehicles here are generally equipped for leaded fuel. There has been discussion in recent months among African leaders that countries should convert to unleaded gasoline in the near future, but Pototsky said retailers here cannot market their gasoline as "unleaded" because it often becomes blended with NNPC fuel of varying grades when stored in tanks.)

¶11. (C) In a separate conversation with Econoff, an ExxonMobil official stated that the downstream industry is now trying to import as much fuel as possible, in effect "flooding the market." He said the marketers are doing so primarily to ensure a steady supply of fuel nationwide. He said that in this time of tense transition to a market-based fuel sector, they do not want to give the unions or any other detractor the opportunity to claim that in spite of deregulation -- or perhaps because of it -- not only has the price of gasoline risen, but the country still faces shortages. Thus, according to the ExxonMobil official, the goal of the marketers for the near term is to flood the market with fuel, and get it distributed nationwide. Along with trying to ensure stable supply and prices, the industry has turned to public outreach to win consumers to the side of deregulation; new radio jingles paid for by the marketers extol the benefits of deregulation.

...BUT HOW DO WE PAY FOR IT?

¶12. (C) The marketer's new problem, according to Pototsky, is getting enough foreign currency to pay for the fuel shipments. Businesses in Nigeria can acquire dollars twice weekly through Nigeria's Dutch Auction System (DAS). Each Monday and Wednesday, the Central Bank of Nigeria (CBN) announces the amount of dollars it will be auctioning. Companies seeking dollars then post a bid via an authorized bank. They specify what amount they seek, at what rate they will exchange naira for that amount, and for what purpose they seek the dollars. An amount of naira equivalent to their bid must be available in their bank at the time the bid is made. On Tuesdays and Thursdays the CBN announces the winning bids, and immediately deducts the equivalent naira from the current accounts of the banks representing the winning bidders. The CBN then transfers dollars into the correspondent bank accounts of the winning bidders. Any dollars not used must be returned to the CBN within five days to be exchanged for naira at the rate the dollars were purchased.

¶13. (C) According to Pototsky, when the President deregulated the downstream sector in a relatively sudden manner last month, his administration did not anticipate the need of the marketers to obtain dollars to pay for fuel imports. Pototsky said that when NNPC pays for an imported shipment, it uses dollars it obtained from crude oil sales kept in accounts outside of the DAS. He told Econoff that marketers now need approximately $120 - $150 million per month to pay for their fuel shipments, and are obliged to obtain dollars only through the DAS. He said they found themselves outbid at several DAS auctions in October, and realized further that their bids could equal up to 35 percent of the dollars sold at any given auction. On November 12 Pototsky told Econoff that while the CBN sold enough dollars to Mobil in the

November 5th auction to cover its outstanding invoices, he is not certain how Unipetrol fared. (Unipetrol was the first marketer to import fuel after deregulation took effect.)

¶14. (U) (Note: The CBN uses the DAS to control the exchange rate, so the amount of dollars it supplies at each auction varies, and the supply relative to the demand can vary widely. For example, the CBN managed to keep the DAS marginal exchange rate at 135.55 naira to the dollar on both November 3 and November 5. However, the amount of dollars sold ($103 million and 331 million respectively) accounted for 82 percent of the demand on November 5 (bids totaled $403 million), and only 30 percent on November 3 (bids totaled $351 million). On November 10, bidders requested $217 million, and the CBN sold $183 million, or roughly 85 percent of demand, maintaining the exchange rate at 135.52 naira to the dollar.)

¶15. (C) Pototsky told Econoff that marketers want the GON to create a separate allocation of dollars available for fuel purchases, or allow for advance funding of fuel purchases. Pototsky also said that he and other marketers are worried that under the current system, they will either not obtain dollars in time to pay their fuel invoices, or the large volume of their bids at any given auction will "decimate" the DAS. The marketers' bids for dollars might create spikes in demand and, if successful, edge out other industries for access to the limited amount of foreign currency allowed by the CBN at each auction. The new managing director of Citibank Nigeria told Econoff that another option the marketers may pursue is to press the GON to allow the companies to buy dollars as an industry block through a "syndicated import letter of credit," rather than individually through the DAS as they do now. That option may become more important in the future if companies choose to order shipments jointly; currently, each company orders its own fuel shipments and sells some of it (in naira) to the others when a shipment arrives in port. (As Mobil's Pototsky told Econoff, "We're tough competitors when it comes to selling product and services throughout Nigeria, but we shouldn't compete bitterly just to get the product here. That could really blow out the market.")

THOUGHTS ON NEW NNPC CHIEF

¶16. (C) At the Businessman's Luncheon, Pototsky and Harvey praised the new group managing director of NNPC, Funso Kupolokun, for his decision to attend a marketers' meeting the day after his appointment was announced (ref H) to reassure the industry of the President's resolve to deregulate and reform the downstream sector. Both men agreed that Kupolokun has been accessible in the past and understands the industry well. However, Bob Smith, MD of ConocoPhillips (upstream), cautioned that Kupolokun may be too "hands on" and not delegate enough decision-making, making the organization more bureaucratic and lethargic. Most oilmen at the table agreed that there is a risk of stagnation within NNPC for the short-term; managers and supervisors may be afraid to act on requests and applications until they get a clear impression of the new GMD's intentions, goals, likes and dislikes. For his part, Kupolokun has publicly stated that he plans a comprehensive review of the organization, and will eliminate unnecessary positions and ineffective workers.

¶17. (C) COMMENT: While it seems deregulation of the downstream sector has taken root, critical issues remain outstanding that might cause significant strain on the system. We will watch for continued complaints from unions and northerners regarding prices, and for attempts by government officials from the north to institutionalize temporary or holdover pricing schemes used to bridge the supply chain as in the past. NNPC's Kupolokun will continue to press for reform, but a backlash is possible from those who benefited financially from the inefficiencies of the old system, and from managers within NNPC ranks he may try to sack along the way. The link between currency exchange rates and the availability of dollars for the marketers to pay for their imports may have an impact on marketers' ordering decisions, and possibly on the valuation of the naira. And implementation of the GON's announced intention to finally repair and privatize the country's refineries could affect both the volume and price of products and the relative strength of the players involved in the entire downstream sector. END COMMENT.

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